

# LFD BUDGET ANALYSIS DEVELOPMENT 2005 BIENNIUM

A Report Prepared for the  
**Legislative Finance Committee**

By the  
**Legislative Fiscal Division**

September 26, 2002



[www.leg.state.mt.us/fiscal/](http://www.leg.state.mt.us/fiscal/)



## **PURPOSE/INTRODUCTION**

The purpose of this report is to solicit Legislative Finance Committee feedback on and concurrence with the proposed scope and focus of budget analysis for the 2003 legislative session.

In prior years, staff effort would primarily be directed toward an examination of the budget submitted by the executive, with other issues and options for consideration by the legislature. Two circumstances cause us to feel we should change our focus:

- 1) The state's projected financial deficit, and the necessity of reconciling a large imbalance between revenues and expenditures -- While the emphasis of the legislature in more stable budget environments is generally on the prioritization of new or expanded services and current revenue sources, this biennium will likely see not only no net expansion, but a retrenchment in government spending from the present law level. The legislature must have a range of options, and must know the ramifications of those options.
- 2) A change in both the content and timing of budget information -- Statute requires that agencies submit budgets by September 1. These budgets normally form the framework for the Executive Budget for most agencies, allowing our staff to get an early start on analysis. The budgets for the 2005 biennium were not only delayed, they do not reflect actions necessary to address the current projected general fund deficit, which the Executive Budget must ultimately do. Therefore, they are of limited use to staff to get a jump on the Executive Budget.

To that end, the LFD intends to expend more resources on the provision of options independent of an analysis of the Executive Budget both to reduce general fund expenditures and enhance revenues. The primary impact of this change would be a less thorough examination of certain aspects of the Executive Budget, with more attention to proposed policy changes impacting larger dollar amounts, and to the ramifications of the reduction (or increase) options provided.

Committee feedback is being solicited not only on the approach, but also on the types of criteria staff will use in exploring and presenting options.

## **CRITERIA FOR LEGISLATIVE OPTIONS**

In analyzing expenditures or revenue sources, establishing a framework for examination will enhance consistency of approach. The following criteria for program review, one-time or ongoing general fund replacement, and revenues and tax policy would be used by the LFD.

### **PROGRAM REVIEW**

The basic philosophical underpinning of any program review is to:

- 1) Articulate and/or explore the policy decisions inherent in the provision of services through expenditure of resources, for legislative consideration and prioritization; and
- 2) Determine the fiscal implications, including whether the current level or methodology of funding is the most efficient and/or appropriate.

These two underpinnings would form the parameters of program review by Legislative Fiscal Division staff for the 2005 biennium budget.

### **Criteria**

Providing program review can require considerable research and general and specific knowledge. As a consequence, staff will have to focus efforts on the most productive areas and will not be able to provide the same analysis for all programs, resulting in limited and selective review.

Because review cannot be comprehensive, and in the interest of objectivity, certain criteria must be used for initial screening and examination. Time constraints, coupled with the state's financial situation, mean that these criteria would by necessity be focused on providing options for lesser and/or more efficient use of general fund. Even with these criteria, however, not all programs or functions meeting the criteria will be examined or even identified.

We propose to use the following criteria for identifying and evaluating programs. Again, it does not mean that all programs meeting one or more of the criteria would be included in the analysis. However, any program discussed would meet at least one of the criteria.

- Not mandated by the constitution, state statute, or the federal government
- Definition of "success" or desired outcome is nebulous or difficult to measure
- Change in "success" rate (need to look to see if lack of resources is impacting)
- High cost of provision (with or without comparison to other programs)
- Readily identifiable customer base
- Few corollary impacts on other programs or services
- Change in funding over time to general fund from another source
- Service recipients have other options to get the service or one similar
- Scale of need is low (no means test, etc.)
- Ill-defined or non-specific customer base
- State is subsidizing what could or should be self-supporting
- Program is duplicated elsewhere

There are a number of factors under which the method or level of general fund support compared to other potential revenue sources for a program might be examined. The LFD proposes to use some of the following.

- New or increased fee for receiving the service
  - Program provides an exclusive benefit
  - Recipients have the ability to pay
  - The general fund subsidizes a portion of the cost
- Incentives to collect from those able to pay
- Refinancing options, including using current fees to fund more functions and free general fund
- New or increased fees on affected industries to cover enforcement/regulation

It is not appropriate to present options without analysis of issues inherent in that option. However, there could be some instances where options will "plant the seed", and the analysis will indicate that time or resources to do an appropriate analysis have not been available, but that the idea appears to have merit. The analysis will also indicate what factors or issues would need to have further analysis to determine whether the idea could be implemented.

## **REVENUE/TAX POLICY REVIEW**

In developing the budget for the 2005 biennium, the legislature will face significant problems associated with reduced or declining revenues. A review of state tax policies and associated revenue collections would assist the legislature by presenting a clear understanding of the current tax structure and aid in determining the impact of any suggested changes.

During the upcoming session, there will be legislative proposals designed to change the current tax base. In past legislative sessions, many tax policy changes have been implemented because of unanticipated tax collections and an influx of several one-time revenue events. The outlook for the next biennium does not appear to hold similar promise. To effectively plan changes in the state's tax policy direction, it would be

appropriate for staff to provide the legislature with factual information on the state's current tax structure and options for modifications to current policies.

## **Criteria**

The LFD proposes to deploy the following criteria as a comprehensive analysis of current tax policy, with regard to the always-present time constraints. A first and necessary step in the process of analyzing tax policy is to compile a composite list of current Montana state taxes. Some of the criteria this list might contain are listed below.

- Initial purpose of tax
  - Was tax originally designed to fund general state operations
  - Was tax originally earmarked for special funding purpose
  - Have changes occurred in the distribution
- Does the taxing authority originate at the state or the local level
- How has the tax changed over time
  - When and by how much has the rate changed
  - How many times has the rate been changed
  - Reasons for changes
- How has the level of taxpayer liability changed over time
  - Have credits been added
  - Have exemptions or deductions been changed
  - What were the reasons for changes in credits, exemptions, and deductions
  - Are the reasons for credits, exemptions, and deductions still relevant
- How has the relative importance of specific tax changed, relative weight
- How does Montana compare to other states
  - Are specific tax rates comparable
  - Does Montana levy taxes other states have avoided
  - Do other states assess taxes that Montana has avoided

Changes in tax policy always bring a level of uncertainty inherent in estimating tax revenues. Adoption of new taxes and changes in existing taxes may become needed to successfully budget for the next biennium. As tax changes are suggested, the LFD proposes to investigate the proposals with the following criteria.

- Does the tax increase revenue or simply shift other tax revenues
- Will the tax have any beneficial effects
- Will collections be volatile
- Can initial collections be estimated and with what degree of certainty
- What populations are affected by changes in specific taxes
- Would changes make the current tax base more/less regressive

Expansion/reduction of the tax base necessitates a thorough understanding of the current base. How and for what purpose the tax base has been established is essential to that understanding. The goal of staff will be to assist the Legislature in better understanding the tax policy of Montana.

## **FUND BALANCES**

The state has utilized fund balances in certain state special revenue accounts to aid in balancing the general fund for a number of years. As a consequence, this area no longer has the potential for options that it once had. In addition, for several biennia the Legislative Finance Committee conducted examinations of each state special revenue account to determine which should be de-earmarked to the

general fund. Among the factors examined was “excessive” fund balances.<sup>1</sup> It is also important to recognize that these options provide a one-time source of funds, and do not contribute to achieving a long-term solution to the budget deficit situation.

## **Criteria**

While the options in this area are reduced due to prior actions, LFD staff intends to examine certain state special revenue funds to determine if fund balances might be utilized to reduce general fund expenditures. A number of factors must be examined when determining whether a fund balance is available for other uses, including deposit to the general fund. We propose to look at a number of factors for initial review, from which certain funds would be chosen for additional examination. The initial factors would be:

- The size of the fund balance
- The percentage of disbursements the fund balance represents
- Net operating expenses

Once the initial review is done, a number of other factors would be examined, including:

- The level and pattern of expenditures and revenues
- Composition of assets and liabilities
- Liquidity of the assets
- Statutory changes required

As with program review, time constraints mean that only certain fund balances will be examined.

---

<sup>1</sup> In large part because it was thought that the number of remaining accounts that could be de-earmarked was too small to warrant continuing to examine each in depth, the Legislative Finance Committee ceased reviewing each account in the 1999 biennium.

## **OTHER BUDGET ANALYSIS ISSUES**

Staff welcomes committee feedback and suggestions regarding other features of the LFD Budget Analysis process, based on the experience of committee members in crafting budgets in prior sessions. This includes the format, quality, and presentation of budget data, its usefulness as a budget tool, and other data/material that may be useful to the legislature in setting budget priorities. Following are statements about the LFD budget analysis that may be of interest to the committee and generate comments.

- The format of the agency budget analysis documents (Volumes 3 and 4) will be essentially the same as for the 2001 legislative session. This is the primary working document for the appropriations subcommittees.
- The revenue estimates will be contained in Volume 2, and will serve as the primary working document for the Revenue and Transportation and Taxation Committees as they craft the revenue estimates
- The “Statewide Perspectives” (Volume 1) will be in a similar format to the 2001 session report, and will focus on a summary of significant fiscal issues, an economic profile and the state fiscal condition, a summary of the executive proposal, significant issues identified by the LFD analysis, and a general reference section.
- The primary emphasis of the LFD budget analysis will be on general fund issues, with consideration of other fund sources where they might contribute to general fund resources
- The staff will bring attention to the structural balance of the general fund, and will emphasize the need for long-term solutions to the budget deficit and adequate budget reserves